

MONTANA STATE FUND 2007 BUDGETED AND ACTUAL EXPENDITURES PRESENTED ON BOTH A CASH BASIS AND AN ACCRUAL BASIS

A Report Prepared for the
Legislative Finance Committee

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May 22, 2008

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INTRODUCTION

The Montana State Fund (MSF) is responsible for providing Montana employers with an option for workers' compensation and occupational disease insurance and guarantees available coverage for all employers in Montana. The management and control of the state fund is vested solely in the Board of Directors.

There are two ways to account for costs:

1. cash basis; and
2. accrual basis

Cash basis includes program costs paid during the year. Accrual basis includes program costs paid during the year and estimates of costs in future periods related to the current year. MSF collects premium revenues each fiscal year. The premiums collected are to provide workers' compensation benefit for workers injured in the year the premiums are collected. The benefits are paid out over an extensive period of time, potentially 40 years or more. The estimates of the future benefit costs are accrued by MSF.

STATUTORY REQUIREMENTS

The MSF budget is presented on a cash basis as opposed to a full accrual basis. By statute, MSF is required to include the entire expense of administering the state fund in its estimated budget. In a formal legal opinion dated November 29, 2007 the code commissioner concluded that *it appears that including "accrued liabilities" as part of the "entire expense of administering the state fund for the succeeding fiscal year" would fulfill the statutory requirement to have the budget for the state fund include "due regard to the business interests and contract obligations of the stat fund" and would adhere to the stated objective of the 1991-1992 Select Committee on Workers' Compensation to keep the Legislature informed of any potential unfunded liability.*

CASH METHOD OF BUDGETING FOR MSF

Figure 1 presents the 2007 Budget of MSF on the Cash Basis.

Figure 1 shows

- Net premium revenues budgeted in FY 2007 are \$214 million. These revenues are used to pay workers' compensation insurance benefits for workers injured in FY 2007 until approximately FY 2047 or longer.
- Operational costs reflect the costs for MSF personal, operating expenses, equipment, and costs directly related to working on claims or allocated loss adjustment expense in FY 2007.
- Benefit payments include the small amount of benefits paid for worker injuries occurring in FY 2007 (\$32.7 million) and claims from previous years for which the premiums were already collected.
- Net reflects the revenues remaining after the operational and benefits payments are subtracted. Net unbudgeted revenues would be used to increase loss reserves for the estimated costs of providing benefits. Net income above that required for reserves can be used to increase contribution to equity or surplus, provide dividends to Montana employers, or pay employee incentives.

Figure 1 Montana State Fund New Fund Cash Method of Budgeting		
	Budget	Actual
Revenues		
Net Earned Premium	\$214,368,000	\$238,202,708
Investment Income	<u>35,500,000</u>	<u>37,919,659</u>
Total Revenues	\$249,868,000	\$276,122,367
Expenditures		
Operational Expenditures		
Personal Services	\$19,441,571	\$19,304,595
Operating Expenses	25,303,990	24,209,304
Equipment & Intangible Assets	2,862,494	2,056,149
Allocated Loss Adjustment Expense	<u>3,752,100</u>	<u>4,607,285</u>
Subtotal Operational Expenditures	\$51,360,155	\$50,177,333
Benefit Payments	<u>\$136,040,792</u>	<u>\$115,849,469</u>
Total Expenditures and Benefit Payments	\$187,400,947	\$166,026,802
Old Fund Administrative Costs	<u>-\$1,250,000</u>	<u>-\$1,250,000</u>
Net	<u>\$63,717,053</u>	<u>\$111,345,565</u>

Old Fund administrative costs are included in the operational expenses budgeted above and are removed to get the net figure for budgeted and actual related to the New Fund.

ACCRUAL METHOD OF BUDGETING

Figure 2 presents the 2007 Budget of MSF on the Accrual Basis.

Figure 2 reflects the same net premium revenues as does Figure 1, as the premiums collected in FY 2007 are the same under both methodologies. The expenditures for the administration of MSF are also the same under both methodologies. The differences between the two methodologies begin with the adjustments to full accrual.

- The reduction for capital expenditures, depreciation, and amortization reflect the difference in recognizing the costs associated with the purchase of equipment and related assets which benefit MSF over several years
- Compensated absences expenses show the increase in the accrued costs of reimbursing employees for sick and vacation leave.
- LAE reserves or loss adjustment expenses are the costs directly related to administering workers' compensation benefit claims. MSF is required to set aside reserves for these costs as well as the costs of workers' compensation indemnity and medical claims. The estimates for these costs increased \$10.6 million over the amount MSF would have budgeted in this methodology. The increased costs of the LAE Reserve Changes are paid from investment income in this example. If the investment income was not sufficient to cover the costs of the increase the costs would be paid from the equity or surplus of MSF.
- The New Fund Benefit Payments in Figure 2 show the estimated costs of the workers' compensation benefits for workers injured in FY 2007 over the period the benefits will be paid out. These are the costs of the benefits which relate to the premium revenues collected in FY 2007.

The net remaining in this example could also be used to pay for contributions to equity, dividend payments, and employee incentives.

Figure 2 Montana State Fund New Fund Accrual Budgeting Method		
Accrual Basis		
Revenues		
Net Earned Premium	\$214,368,000	\$238,202,708
Investment Income	<u>35,500,000</u>	<u>37,264,000</u>
Total Revenues	\$249,868,000	\$275,466,708
Expenditures		
Personal Services	\$19,441,571	\$19,304,595
Operating Expenses	25,303,990	24,209,304
Equipment & Intangible Assets	2,862,494	2,056,149
Allocated Loss Adjustment Expense	3,752,100	4,607,285
Adjustments to Full Accrual		
Reduce for Capital Expenditures	-2,862,494	-2,056,149
Depreciation	545,750	453,815
Amorization	1,500,642	905,704
Compensated Absences	276,150	203,079
LAE Reserve Changes	<u>5,940,817</u>	<u>16,549,013</u>
Subtotal Operational Expenditures	\$56,761,020	\$66,232,795
New Fund Benefit Payments	<u>\$ 187,849,000</u>	<u>\$ 186,616,838</u>
Total Expenditures and Benefit Payments	\$244,610,020	\$252,849,633
Old Fund Administrative Costs	<u>-\$1,250,000</u>	<u>-\$1,250,000</u>
Net	<u><u>\$6,507,980</u></u>	<u><u>\$23,867,075</u></u>